

## **Fitch Lowers California GO Rating to 'A'; Leases to 'A-'; RANs to 'F2'; Negative Rating Watch Stays**

Fitch Ratings-NY-December 20, 2002: Fitch Ratings has lowered State of California general obligations to 'A' from 'AA'. The action affects \$25.2 billion outstanding bonds. In addition, ratings assigned to lease obligations of the state have been lowered to 'A-' from 'A+'. The bonds are issued by the Board of Public Works, the Franchise Tax Board, East Bay State Building Authority, Los Angeles State Building Authority, Oakland State Building Authority, Riverside County Public Financing Authority, San Francisco State Building Authority, San Bernardino Joint Powers Financing Authority (California Department of Transportation) and Sacramento City Financing Authority. All of the ratings remain on Rating Watch Negative.

The rating on California's \$12.5 billion revenue anticipation notes (RAN's) is lowered to 'F2' from 'F1'. The notes mature \$9.5 billion on June 20, 2003 and \$3.0 billion on June 27, 2003.

Despite the fundamental strength of its economy, California has been under financial pressure since 2001, reflecting in part recessionary conditions, but, more importantly, a steep, unprecedented drop in personal income tax receipts due to a precipitous decline in capital gains, bonuses, options, etc. The yield from the tax in fiscal 2002 was 25% below the previous year, falling from \$44 billion to \$33 billion. In this fiscal year, which ends on June 30, 2003, the tax is now expected to be about 12% short of the budget estimate and be at about the same level as last year.

The effects of both the economy and the sharply reduced capital gains base are expected to continue into 2003-04. The most recent estimate is that a gap of almost \$35 billion exists for the remainder of this year and fiscal 2004. Unrealized revenue is set at about \$18 billion of which the personal income tax accounts for over \$12 billion, while higher expenditures are set at \$4.5 billion. The remainder of the gap represents non-recurring actions taken to balance the original 2002-03 budget; securitization of the state's tobacco settlement accounts for \$4.5 billion of the \$12.6 billion total in this category.

The magnitude of the problem, over 20% of the budgets, will require significant actions. The governor has proposed expenditure measures totaling some \$10 billion and other measures will be recommended when the executive budget for 2003-04 is formally

submitted. However, proposals to increase revenues were not approved for the 2002-03 budget and there are indications that resistance to that approach continues.

The lower level of revenues will have a direct impact on cash flow. Estimates made in October indicated that about \$6.8 billion of unused borrowable resources would be available to the state's general fund after payment of the RAN's. The new estimates have lowered revenues by \$8.5 billion, including \$2.3 billion from prior years, and increased expenditures by \$1.6 billion. Together, these changes are more than \$10 billion, or well in excess of available funds. In the absence of prompt action, repayment of the RAN's may well rely on the state's ability to issue revenue anticipation warrants, which can extend over the close of the fiscal year.

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